



# Legislative Audit Division

## Performance Audit Summary

### Right-of-Way Acquisition Process

October 2006

#### Introduction

The Montana Department of Transportation (MDT) purchases property from property owners to construct the state's highways and bridges. Property purchased for highway construction purposes is referred to as right-of-way. MDT officials requested a performance audit of the department's right-of-way acquisition process to determine if administrative settlements used to acquire property were "supported and justified." Administrative settlements are payments to property owners based on an agreed upon value of the property acquired that exceed the property's appraised value. The Legislative Audit Committee approved the department's request.

#### Federal and State Laws Protect Property

Protecting property owners is the fundamental principle of federal and state laws related to right-of-way acquisition. The purpose of these laws is to ensure property owners are fairly compensated for property acquired for public use. Federal and state laws governing the right-of-way acquisition process are found in: the U.S. Constitution, U.S. Code, the Montana Constitution, and Montana law.

#### The Right-of-Way Acquisition Process

Right-of-Way acquisition is the responsibility of MDT's Right-of-Way Bureau and five district offices. Right-of-way acquisition is a difficult task because MDT is generally trying to acquire property that is not for sale and property owners can be reluctant to sell. Consequently, the process often does not involve a willing buyer seller relationship. Acquiring right-of-way involves two main steps - property valuation and negotiating with property owners. Property valuation is the process of appraising property to determine its fair market value and the amount of compensation to be offered to property owners. Once compensation is determined, the department begins formal negotiations to purchase the property.

#### Four Types of Acquisition

MDT efforts to acquire property can result in four different types of settlements. These include:

1. Negotiated settlements occur when property owners agree to settle for what the department determines is just compensation based on the appraised value.

2. Administrative settlements occur when property owners and the department reach a final settlement that is more than the appraised value (i.e. just compensation determination) and are often used to resolve differences in opinion between property owners and MDT.
3. If a negotiated or administrative settlement cannot be reached, negotiations transfer to MDT's Legal Division. Legal Division staff conduct further negotiations with property owners. A legal settlement occurs when negotiations between MDT's legal staff and the property owners result in successful acquisition.
4. Condemnation is not used until all attempts to reach a mutually satisfactory agreement through negotiations are exhausted. In the last 12 years, only three parcels of property have gone through formal condemnation proceedings (i.e. referred to a jury for trial).

#### How Much Right-of-Way Has Been Purchased?

During federal fiscal years 2004 and 2005, the department acquired 1,644 parcels of right-of-way costing approximately \$24.8 million. Approximately \$18 million of the total was spent using administrative settlements. These settlements included payments to property owners of approximately \$10.3 million for the parcel's appraised value plus an additional \$7.7 million over appraised value.

#### The Right-Of-Way Acquisition Process Has Several Strengths

Audit work concluded MDT's right-of-way acquisition process has a number of strengths that ensure the process generally works as intended. These strengths include:

- The department appraises all property it acquires for right of way to determine fair market value.
- Department staff and private sector appraisers meet needed qualifications.
- Appraisals are independently reviewed and approved by appropriate department personnel.
- Staff responsible for appraisals and negotiations work independently of each other. Negotiations are well documented and department staff emphasizes fair and positive interactions with property owners.
- Most property owners indicate they were allowed input and were treated professionally by MDT staff.

## **Improvements in the Appraisal Process Could Strengthen Controls**

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Property was not always appraised using the most appropriate appraisal format. Appraisals did not always use appropriate comparable properties or include replacement items (such as septic tanks or fencing) when calculating fair market value. As a result, administrative settlements were used to correct valuation errors caused by incorrect appraisal formats. Appropriate appraisal formats were not always used because the department's Review Appraisers were generally not involved in establishing an appraisal's scope-of-work. They had limited input in determining the type of appraisal and potential issues that could arise. ***The department should improve its appraisal process by involving Review Appraisers in developing the scope-of-work for appraisals.***

## **Offers Based on Outdated Appraisals**

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Federal regulations and department policy require the department use a property's current appraised value. However, outdated appraisals were used as the basis to make offers to property owners on several occasions. For example, one parcel had an appraisal that was 525 days old which resulted in the department paying the property owner approximately \$118,000 over the appraised amount (using an administrative settlement) to account for several issues related to the outdated appraisal, including rapidly rising property values. Outdated appraisals also resulted in ineffective negotiations between department staff and property owners. ***The department needs to ensure appraisals are updated prior to making initial offers to property owners so they reflect current market conditions.***

## **Negotiation Process Can be Improved**

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Department negotiations with property owners were not always conducted in an efficient manner. These inefficiencies lead to longer negotiations and administrative settlements that increased the cost of acquiring the parcel. Examples of negotiation weaknesses included using outdated information to initiate negotiations with property owners, MDT staff not acknowledging counter offers from property owners, and the department not making counter offers to property owners. We generally did not find documentation indicating MDT staff obtained input from MDT Legal Division prior to discussing condemnation as an option. ***MDT negotiation policies need to be clarified in several areas including: counter offer and response requirements, documentation requirements regarding input from MDT legal staff, and acceptable negotiation tactics and timeframes.***

## **Improving Documentation of Acquisition Activities**

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Files did not always contain documentation or information justifying the need for the administrative settlement. Most

significantly, as administrative settlement amounts increased there tended to be less documentation supporting or justifying the administrative settlement decision. Federal regulations require decisions to approve administrative settlements be documented and the amount of documentation be commensurate with the size of the settlement. Department right-of-way policy provides limited guidance on what type of documentation should be maintained. ***Current policy should be clarified to improve documentation and better support decisions on why administrative settlements were paid.***

## **Data Collection Problems Impact MDT Reporting and Management Efforts**

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Data collection problems are affecting several management and operational areas related to right-of-way acquisition. Examples of data collection problems included some administrative settlements being overstated, time to complete acquisition steps is not measured, and all acquisition costs are not tracked. ***The department needs to implement a measurement system that includes program objectives and performance measures. Then, the department needs to collect data that is relevant, complete, and accurate to determine if objectives are being met.***

## **Improve Intra-Department Communication**

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MDT uses a decentralized organizational structure to acquire right of-way. Limited communication was taking place between district office staff and Right-of-Way Bureau (Helena) personnel regarding right-of-way acquisition activities. For example, districts do not always obtain bureau approval, as required, to pay administrative settlements over established limits. Districts have a tendency to focus on their immediate activities and become less involved or separated from other department functions. ***The department needs to identify and implement strategies to improve intra-department communications.***

## **Implementing a Quality Control System**

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An underlying reason we identified weaknesses in the right-of-way acquisition process was the department did not have a quality control system in place to verify staff comply with established policies and monitor program activities and operations. The department is in the process of developing a quality control system for the acquisition process. However, the process it is developing places responsibility for quality control reviews at the district level. To ensure statewide consistency and compliance with right-of-way laws and policies, the department needs to modify its quality control system to ensure it provides statewide consistency and compliance in right-of-way acquisition

For a complete copy of the report (06P-09) or for further information contact the Legislative Audit Division at 406-444-3122; e-mail to [lad@mt.gov](mailto:lad@mt.gov); or check the web site at <http://leg.mt.gov/css/audit/>